DIVISION OF THE HUMANITIES AND SOCIAL SCIENCES

CALIFORNIA INSTITUTE OF TECHNOLOGY

PASADENA, CALIFORNIA 91125

THE POLITICAL FOUNDATIONS OF REGULATORY POLICY

Roger Noll

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ABSTRACT

The purpose of this paper is to contribute to the political economic theory of regulatory policy in two ways. One is to examine regulation in relation to other policies that might be seen as alternatives to it. Existing theory argues that regulation is likely to be too particularistic and cumbersome to serve the efficiency objectives that constitute its justifications in welfare economics; however the relative performance of regulation in comparison with other approaches to the same types of problems has not been extensively explored. The second aspect of this paper is that it examines the relationship of the performance of regulation to the basic political structure of a country: whether legislatures are elected on the basis of proportional representation or from single-representative constituencies, and whether a country has a parliamentary system or separate, autonomous legislative and executive branches. By broadening the range of policies analyzed and the political institutions in which it operates, the possibility is created for making useful international comparisons of the performance of alternative approaches to the market-failure problems that are associated with regulatory policies.

THE POLITICAL FOUNDATIONS OF REGULATORY POLICY

by Roger Noll*

Since 1970, scholars in economics, law and political science have applied microeconomic models of political behavior to produce important new insights about the political causes of regulatory policies. Like much of the work in applied economics, research on the political economy of regulation normally addresses a specific policy question in a specific country, and hence, implicitly or explicitly, takes as given a particular set of political and economic institutions. Most of this research is by Americans, and so is based on assumptions about the political system that hold in few countries. Examples are the separation of powers between the executive and legislative branches of government, the special features of the American Constitution (especially the due process amendment), and the structure of the American legislative system. Consequently, the generalizability of this work is dubious.

This paper provides a step towards a more general political economic theory of regulation. First, it discusses the ways in which

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*Institute Professor of Social Sciences, California Institute of Technology. Exceptionally useful comments on an earlier draft were provided by Bruce Cain and John Ferejohn.

alternative political institutions (e.g. proportional representation versus single-member geographic districts as a means of electing a legislature) might affect regulatory policy. Second, regulatory policy is examined in a broader context than is usual, but not so broad that it encompasses all public policies. The purposes of these extensions are to internationalize this field and to facilitate international comparisons of related policies.

The premise of this paper is that a general political economic theory of regulation can provide useful insights about how policy is formulated, and how more effective policies might be adopted. This view is controversial. Some disagree with any attempt to internationalize the study of political institutions. Many scholars of comparative political and economic systems believe that the values, cultures and political structures of countries are so different that attempts to generalize across national boundaries are worse than useless -- they are perilous, for what appears to work in one context is likely to be disastrous in another. Another source of controversy is the belief that a comprehensive political theory of regulation for a specific country is a useful pursuit. For example, James Q. Wilson argues that no useful political generalizations across regulatory policies are likely to prove true. Of course, negative propositions cannot be proved, so these dissents amount to a warning that general theories of political behavior bear the burden of proof: they must provide nonobvious, empirically verifiable insights.

This paper does not attempt such a proof because it is not

empirical. Nevertheless, it contains numerous theoretical conclusions that are susceptible to empirical tests.

The theoretical perspective of this paper is distinctly that of microeconomics, or rational actor theory. The analysis builds upon the existing literature that explains regulatory policy as the result of actions by organized interest groups to obtain favorable redistributions of wealth. It departs from this approach in several ways. First, it incorporates mass political movements, organized by political entrepreneurs, as a potential countervailing force against organized interest groups. Second, it examines the role of uncertainty and incomplete information in decisions made by voters, politicians and bureaucrats. Third, it explores how different electoral institutions produce different political incentives.

The paper reaches several conclusions that are at variance with received wisdom. One is that the distributional orientation of regulation is not primarily due to the influence of organized special interests, but is a characteristic of representative democracy. Second, in the long run regulation may be less sensitive to particularistic distributional pressures than other types of public policies. Third, the political conditions that lead to cartelization by regulation should also lead to subsidies of the cartel. Fourth, the variance in regulatory policies in relation to the exhibited degree of protection of particularistic interests should be lower in countries that elect legislators by proportional representation, rather than from single-representative constituencies; however, the mean effect on regulatory policies is indeterminate, as is the effect of parliamentary systems in comparison to the separation of powers between executive and legislative branches.

The theoretical argument is laid out in Section II. A necessary preamble is to state the definitions and assumptions on which the theoretical argument is based. These are laid out in Section I. Section III provides a summary and conclusion.

I. Preliminary Definitions and Assumptions

In developing a political theory of regulatory policy, a necessary first step is to define regulation. Most of the literature on regulation adopts a relatively narrow definition: regulation consists of policies that are intended to correct for market failures by the promulgation and enforcement of rules constraining participants in a market. The litany of market failures includes natural monopoly, incomplete information, and external effects. A more narrow definition requires that the rules be written by a regulatory agency rather than in law by elected political leaders. Neither definition includes alternatives to regulation, such as corrective Pigovian taxes and subsidies. laws regarding liability and negligence, nationalization and public enterprise, the creation of new property rights and a market for exchanging them, such as, for example, marketable permits to emit pollutants, or legal self-regulation by industry of various forms, including European corporatism, the National Recovery Act in the U.S. during the 1930s, and Italian syndicalism from

the same era.

For our purposes, the broader definition is required, and the scope of analysis must include alternatives to regulation. The decision to change regulatory policy can usefully be separated into three choices. The first is the decision to take some action that alters the performance of a class of economic activities, where performance here refers to both economic efficiency and the distribution of wealth. The second is the selection of regulatory rules from among the policy instruments listed above. Third, once political decision makers decide to select rules, they must decide how much authority to delegate to an implementing organization. Regulatory laws can contain detailed rules, leaving to a bureaucracy the problem of enforcing and perhaps elaborating and clarifying them, but giving the agency little opportunity to make policy. Alternatively, laws may contain vague, general instructions to an agency, delegating to the professional bureaucracy or the courts the responsibility for making rules. The latter choice gives the agency or the court a substantial role in developing regulatory policy.

Regulation is not alone in having this third step. For example, public enterprises can be more or less closely controlled by the political process. For example, western democracies differ in the autonomy of national broadcasting entities. In the United States, the postal system underwent a transition in the 1970s from a ministry subject to close political control to a virtually independent public enterprise that is overseen by a new regulatory agency, the Postal Rate

Commission.

An important challenge to the political economic theory of regulation is to provide insight about the rationale for decisions at each stage. When analyzing the decision to intervene, the theory must incorporate the full range of policy instruments that can be used to change market outcomes. Hence, in his influential paper, Stigler adopts a definition of regulation that includes almost all forms of government activity, including commodity-specific taxes (the whiskey tax), tariffs and import quotas, subsidies (airport subsidies to benefit airlines as well as industry-specific subsidies, as in agriculture), some kinds of public enterprise (airports are typically owned by government entities), and the more prosaic forms of regulation (controls on prices, entry, product quality and packaging, workplace safety, land use, and emissions of pollutants).

When analyzing choices at the second and third levels -- what form of instrument to use and how much authority to delegate -- a further challenge arises. We need to understand how the political implications of these choices differ.

The roles and powers of elected political leaders, bureaucracies and courts differ substantially among nations, causing potentially important differences in the implications of a decision to create a regulatory authority. In the United States, the Constitution sets forth limitations to the procedures adopted by regulatory agencies, the authority of the legislative branch and its ability to delegate, and the rules an agency can promulgate. The

Constitution guarantees citizens equal protection under the law, and due process in matters that affect them significantly. The implications for regulation are that decisions must be based upon substantial evidence, affected parties must be given the right to participate in the process by submitting evidence and argument in support of their interests, decisions of an agency must be logically derived from its legislative mandate, and decisions are subject to judicial review should any affected party believe that these requirements have not been satisfied.

In other countries, regulation need not be so cumbersome and decision makers so constrained; however, statutes can include complex procedural requirements and extensive judicial review, such as the review of environmental policies by the administrative court in the Federal Republic of Germany. Even in the United States, agencies differ in the extent to which authorizing legislation imposes procedural constaints beyond the minimum constitutional requirements. In each case, the question remains as to how political incentives affect choices regarding the extent of delegation and procedural requirements.

The Behavioral Assumptions

Microeconomic theory presumes that choice is rational and purposive -- that its purpose is to obtain some valued end. The objective of political leaders is presumably to secure political power. Usually this means maximizing the probability of winning an election for public office; however some may seek to advance to a political position having greater power and status. In any event, the key point is that political incentives govern the choice of policy objectives, policy instruments, and assignments of responsibility for making detailed policy decisions among political leaders, the bureaucracy and the courts. Consequently, political economic theory must include a theory of the political consequences of a choice of policy. instrument an delegation.

In western democracies, political success depends on the electorate. Hence, a political economic theory of public policy must be built on a theory of elections and, in particular, the relationship between policy and voting. This in turn requires behavioral theories of voters and candidates.

Political economic theory assumes rational choice in elections, as elsewhere. Voters are assumed to engage in political activities (voting, working as volunteers, contributing to campaigns, lobbying) as part of the quest to maximize personal welfare, subject to a budget constraint. Government can supply public and private goods, affect the prices and qualities of private goods, and alter personal income through taxation, through transfer payments, and by affecting factor prices. Political economic theory assumes that voters select a strategy for political participation that takes account of the many ways in which the political process can affect their welfare.

The rationality assumption about voters is controversial. The alternative view is that voting behavior is affective and has no

policy significance. Each voter is identified with a rung on the socioeconomic ladder, and votes for the party or candidates appearing to be on the same rung. But information is incomplete, and so, as Edelman argues, voters can be misled by emotional appeals and symbolic issues. Elections then become competitions for power among elite groups; policy making divides the spoils among elites, rather than responding to the wishes of the electorate. Some hold that this makes the study of elections and voting behavior largely uninteresting and certainly pointless from a public policy point of view. The implications for regulatory policy are essentially Marxist: symbolically, regulation may be represented as protecting the population from some market failure, but in reality it maintains a cartel for a ruling elite (see, for example, Kolko on American railroad regulation).

The competition between the two theoretical approaches ought to be resolved by testing which better explains the development of public policy. At another level, however, the two approaches have less difference than might appear at the surface. If political elites are not unified and homogeneous, competition among parties for informed, competing elites is a candidate for study using the rational choice approach. Perhaps many voters do not engage in political participation on the basis of rational choice; however, elections are decided, so to speak, "at the margin" — by the voters who have a stake in the choice -- as long as parties compete and elite groups have conflicts of interest. Elections may have little normative significance because many voters face little or no real stake in the outcome. But elections will have significance in deciding which directions policy will take among competing elites. This makes studying the electoral foundations of public policy worthwhile. Even after the revolution, it will be useful to know how policy outcomes differ among different democratic processes.

The final important group of actors in the policy making drama is professional civil servants. The tenets of economic analysis require that they rationally pursue personal objectives. Unfortunately, there is considerable disagreement as to what bureaucrats maximize. The candidates are job security, permanent income (perhaps by obtaining better-paying private sector jobs), and political advancement. Another view is that the issue can be finessed: the bureaucracy can be assumed to execute more or less perfectly the commands of the political leadership. At the other extreme, Niskanen's influential theory assumes that agencies, in maximizing their discretionary budgets, possess so much power that they act as monopolists at appropriations time. This implies that bureaucrats, not politicians, industry or the general population, reap most of the profits from regulation.

In this paper, we will assume that neither bureaucrats nor political leaders possess monopoly control over public policy. This is an assumption of inconvenience: it requires that political economic theory include both bureaucrats and politicians, and leaves as an empirical matter ascertaining their relative influence. As further

inconvenience, no restrictions will be placed on the motives of bureaucrats: they may seek security and the quiet life, greater political power within one agency or through promotion to another, or greater economic rewards in the private sector.

Summary

The preceeding discussion sets the stage for the next section. The important definitions and assumptions are as follows. The political economic theory of regulation deals with, first, the decision to intervene in a market, second, the decision to attack the problem by writing behavior rules, and third, the decision to create a regulatory agency, the decision about how much authority to delegate and how elaborate a procedural requirement to impose. Regulation refers to altering the performance of a market by promulgating and enforcing rules governing the production, qualitative attributes, entry and/or price of a good that is bought and made by others. All of the relevant actors are assumed to be rational and motivated by self-interest, whether voters, politicians, bureaucrats or participants in regulated markets.

II. The Political Economic Theory of Regulation

If political officials are rational, the decision to regulate must be based upon a realization of the performance characteristics of regulation. These effects can usefully be classified as either generic, applying ubiquitously, or particularistic, affecting a well-defined subset of society.

Breyer has introduced the notion of match and mismatch between regulatory objectives and the method used to achieve them. A mismatch occurs when the method is not effective for attaining the objective. Breyer's analysis assumes that the purpose of regulation is to correct market failures, but here no such assumption is made. Our concern is why the choice of regulation matches political incentives operating upon elected decision makers, regardless of the match with normative economic theory. Thus, the political economic theory of regulation must begin with a characterization of what political officials are likely to expect from regulation -- even a mismatch.

The Effects of Regulation

The most obvious characteristic of regulation is that it must change the economic efficiency of a regulated market. It must do so because it imposes costs: regulated firms must provide information to regulatory officials, keep informed about regulatory requirements, and maintain internal systems for assuring compliance (or, perhaps, optimal noncompliance). Even if regulation imposes a nonbinding constraint, the paperwork requirement alone alters the equilibrium in the regulated

market; however, applying a rationality assumption, it is implausible that an agency would be established to impose nonbinding constraints. If regulatory constraints are binding, the net efficiency effect of regulation can be positive or negative, depending on whether it ameliorates a market failure and the costs in doing so. This can usefully be termed the comparative statics effects of regulation: the net surplus generated by it.

The second characteristic of regulation is its effects on dynamics: the speed with which a regulated market adjusts to a new equilibrium in response to changed conditions (demand, availability of resources, technological change, etc.). Regulation slows change by creating an extra step in the process whereby an economic agent adjusts to changed circumstances. One way in which regulation slows change is to retard entry. Potential entrants must receive approval from regulators, a time-consuming process that also entails announcing intentions to incumbent competitors.

Although retarding change is normally regarded as detracting from economic efficiency, Owen and Braeutigam point out that it does not necessarily do so. By retarding change, regulation reduces uncertainty. Exogenous shocks that upset market equilibrium are public goods, and can impose a net cost. One element of cost is associated with risk aversion, but there are others. Fluctuating markets may require frequent recontracting or other means of introducing flexibility into long-term relationships between buyers and sellers. If renegotiation is costly -- or if people do not like to bargain -- a process that retards adjustment to changed circumstances can produce net benefits.

The third characteristic of regulation is that it creates and destroys wealth. This is a necessary companion to the other characteristics: changing the efficiency of a market and its response to changed circumstances affects the wealth associated with a market. But the wealth effects of regulation go beyond its efficiency aspects. First, they are more particularistic: regulation can redistribute wealth among various participants. Second, regulation can create or redefine property rights in ways that have no efficiency consequences, but that determine who captures the surplus generated in a market.

Regulation creates and destroys wealth in numerous ways, described more completely in Noll and Owen. Here a few examples illustrate the general process. For instance, by retarding entry, regulation creates a property right in the status quo that has market value equal to the costs of gaining regulatory approval to enter. In addition, regulation benefits suppliers who are more adept at participating in the regulated market than at the unregulated equilibrium (number of firms, price, quality of product, available production method). For example, if regulation increases product quality, firms adept at producing high quality goods will experience a windfall. Regulation also enhances the wealth of entrepreneurs who are adept at dealing with government in comparison to those whose skill is understanding production technology and market demand. Thus, regulated industries will have different winners and losers than they would

without regulation. Consequently, the wealth of incumbents will depend on the continued presence of regulation.

A fourth characteristic of regulation relates to the process by which agencies establish and enforce rules. Although western democracies differ according to the limits on decisions by elected political authorities and by bureaucrats, the latter are generally more constrained than the former. More specifically, regulatory agencies are more constrained by evidence than are political leaders and other administrative organizations. Evidence is generated by two principal sources: the agency itself, and participants in the regulated market who supply the agency with information.

The dependence of regulatory agencies on evidence gives rise to rules regarding the weight accorded to evidence, the evidentiary requirements to sustain a court challenge to a decision, and the rights of outsiders to participate in the process (e.g. rules of standing). Regulatory agencies are more court-like than legislatures or other kinds of bureaucracies; however rules of evidence and standing in courts usually are more strict than in regulatory proceedings.

The significance of procedural requirements is as follows. First, they affect the costs of effective participation: one must prove that the standing qualifications are satisfied, and must submit information that satisfies evidentiary standards. Second, they affect the potential benefits from participation: because decisions depend upon evidence, a failure to participate runs the risk that no evidence will be submitted in support of a favorable decision, even if the agency is disposed to make it. Third, they affect the character of participation: in contrast to processes with less strict evidentiary rules, technical information has a relatively higher value in comparison to more informal, personal activities, such as lobbying. Thus, economists, engineers, lawyers and scientists are more influential in regulatory decisions than in legislative activities or most other forms of executive decision making.

The last characteristic of regulation is that creating a regulatory agency and embarking on a new regulatory program does not necessarily require that there be immediate winners and losers in the political struggle. When legislation is passed, its opponents have lost; however, as Fiorina argues, what they have lost, and whether there are compensating gains, is conjectural.

Consider the approaches available to control pollution. When regulatory laws are passed, a polluter can expect higher costs, so in that sense is a loser. But the stringency of regulation remains in doubt -- and depends upon evidence and argument to be supplied by the firm. Moreover, once a firm has had standards adopted for its emissions, it has a *de facto* property right in a valuable resource -- waterways and airsheds to dispose of waste. This is not available to potential entrants until they, too, can run the regulatory gauntlet -- with, in all liklihood, more stringent requirements being applied to them than to incumbent firms. By contrast, consider two widely discussed alternative strategies for dealing with pollutants: an emissions tax or stricter laws regarding public nuisances. In both

cases, all polluting firms can expect losses, and no new entry barriers will provide partially offsetting benefits. Indeed, if firms face generally lower abatement costs, either policy enhances the prospects of entrants. Thus, the enactment of either approach is an immediate loss for the losers.

An alternative to economic regulation is public enterprise, either nationalizing existing companies or creating a publicly-owned competitor. Once again, this is more clearly a threat to the industry than the creation of public utility regulation to control their prices and profits.

Although the five characteristics of regulation apply to all cases, the magnitude of their effect is controlled by the political leadership. The following examples illustrate means to vary these characteristics.

- The extent to which regulatory policy serves economic efficiency objectives can depend on whether regulators are required to undertake manadatory benefit-cost analyses of proposed rules.
- The degree to which regulation slows change depends on whether legislation creates a legal monopoly or contains a presumption in favor of competition, and on whether it writes rules related to performance or with respect to inputs and entry into a market.

- The manner in which regulation distributes and creates wealth depends on whether it sells or gives away its implicit property rights, and whether it has a budget for compensating losers.
- The weight of the evidentiary burden of an agency depends on its budget for research and analysis, the vagueness of its legislative mandate (greater detail creates a greater burden of proof that a rule carries out the legislative mandate), and the grounds written into legislation as a legitimate basis for appealing decisions to the courts.
- Legislation can create identifiable losers by specifying rules that cleary hurt someone, rather than by delegating the responsibility for writing the first generation of rules.

This paper assumes that political actors are generally aware of these characteristics of regulatory policy, and decide to adopt a policy having these characteristics because it is in their self-interest to do so.

The Theory of Participation

To identify the conditions under which regulation (or deregulation) is a rational political act in a democracy requires a theory of citizen political participation. In rational actor theory, the focus is on how citizens allocate scarce resources among political

activities, assuming that they rationally pursue self-interest. We focus on participation in political activities, realizing that there are unspecified trade-offs between political participation and other ways to use resources. In the sense used here, political participation covers a variety of activities: voting, lobbying political leaders, contributing resources to parties and candidates, participating in policy-making processes (such as regulatory proceedings), and initiating legal challenges to unfavorable policies, including regulatory rules.

Imagine each citizen as solving an optimization problem involving the use of two scarce resources: time and wealth. The citizen's objective is utility maximization, subject to budget constraints on wealth and time. Among the arguments of the utility function are goods provided by government, whether public or private. Entering the budget constraint are factor prices that depend on government actions, taxes and subsidies, and contributions to political organizations. The time constraint also incorporates allocations to political activities.

Regulation enters the optimization problem in several ways. First, regulatory actions affect the arguments of utility functions by changing the quality of private goods and the consumption of externalities. Second, regulatory actions enter the budget constraint by changing factor and product prices. Third, the benefits and costs of participation in regulatory policy making must be taken into account. This requires making regulatory actions a function of a citizen's political participation, and including participation costs in the budget and time constraints. Of course, other policy instruments are incorporated into the optimization problem in the same way.

Although forms of political participation are numerous, we will focus on four categories: voting, contributing to parties and candidates, taking part in the policy making process (lobbying, participating in regulatory proceedings, appealing government decisions to the courts) and participating in organizations that engage in political activities. This list is not exhaustive; for example, it ignores policy research and articles or speeches intended to convince voters to favor a policy. For most citizens, however, the list includes the important relevant alternatives.

Voting Behavior

The most important characteristics of voting are that it is cheap and that it is a low information process. Voting consists of sending a simple dichotomous signal to parties and/or candidates, each of which offers a complex combination of positions and other relevant characteristics such as integrity, administrative capability, and ideology. Each vote has little effect so voters have little incentive to allocate effort and resources in fine-tuning judgments about ballot alternatives, other than to the extent that acquiring political knowledge is an enjoyable consumer good.

These features of voting have several important consequences. First, voters will pay attention to few issues in an election. Second, most issues will be expressed at high levels of generality, incorporating several related policies. Examples are the overall performance of the economy, the general state of international affairs, the leadership qualities of candidates and party leaders, and ideology. More specific issues (health care, education or regulation) can become salient issues -- but few will achieve this status. Third, because information is sparse, campaign strategies involve providing selective free information and establishing the agenda of the debate.

In this milieu, the rational voter first asks what policies are most important to his or her welfare, and then examines historical records, information from mass media, interest groups, and candidates and parties to decide how to vote. One element of the calculation is the provision of government goods -- defense, health care, education. Another element is particularistic government activities. Government employment and procurement are direct sources of a substantial fraction of income. Government also affects income through taxation and regulation. Expenditure programs may supply public goods that enter many utility functions, but they do so by awarding contracts and employing workers. The latter are more concentrated than the former, so that winners and losers on the expenditure side have more per capita welfare at stake in a program than do most consumers of the public good.

Regulation also has a diffuse impact on the users of regulated products, and a concentrated impact on people who earn income in the regulated industry. Regulatory cases can be highly particularistic, like procurement, if they apply to a specific firm; however, much regulation is more general, consisting of rules to guide case-by-case decisions. Rules are in part public goods with exclusion. Part of the effect is shared by people whose income is collectively and simultaneously affected by them.

Rational voting decisions must be based on both aspects of government. For each person, government will have a shared, diffuse effect through general taxation, public goods, and prices of widely-purchased goods, and particularistic effects, entering primarily through the budget constraint. If voters believe that elections are equally important in deciding both generic and particularistic effects, and possess equal information about both, they will weigh each equally in evaluating competing candidates and parties. But the likely case is that voters give greater weight to particularistic effects.

One reason is that voters are unlikely to be equally well-informed about all issues. Because voters will not bear much cost to become informed about an issue in which they have low personal stakes, they are likely to have uneven information across issues. In the aggregate, the importance of each category of public good may be very high; however, for a voter whose income depends on government contracts or regulations, the importance of the latter is likely to be larger. Hence the incentive is greater to be informed about the implications of the election on particularistic affects. Political leaders respond to this situation by claiming credit for income-producing actions of government when communicating with the lucky

winners.

Regulatory policy illustrates these general characteristics. If regulation attacks a market failure, it provides diffuse benefits to numerous voters. In some cases, such as environmental regulation, voters may easily perceive a great stake in the issue; however, most regulatory policies are narrow and have a small per capita impact on citizens. The per capita stakes of people in a regulated industry are much higher. Consequently, when the generic issue of regulatory policy is not salient, the income side of regulatory policies will have more electoral significance than the correction of market failures.

The relative importance of particularistic versus generic issues in voting decisions is likely to depend on the form of government system. Consider two extremes in the spectrum of forms of representative democracy. One is separate legislative and executive branches, with legislators elected from single-member constituencies, such as in the United States and France in the Fifth Republic. The other is a parliament elected by proportional representation from party lists which are selected and ordered by a central party authority. The former provides legislators with an opportunity to be autonomous from parties if they are popular with constituents. Collectively, these legislators have an incentive to construct a legislative process that enables them to provide services to constituents so that they can claim credit for particularistic actions (contracts, construction projects, etc.). A rational voter will then see a representative as a relatively powerless single vote on generic policy issues, but a monopolistic supplier of particularistic favors, as explained in Fiorina and Noll. If a legislator functions effectively in this role, challengers will face a disadvantage in an election, for their ability to provide favors will be conjectural against the proven ability of the incumbent. Thus, legislators will downplay their role in generic (and especially controversial) public issues, and emphasize their role in obtaining particularistic favors.

In a parliamentary system with nationwide proportional representation, the close pairing of generic and particularistic issues is inescapable, but here particularism is still a potent political force. Voters will still feel the particularistic effects of government, and vote in part on the basis of them. Parties will behave like individual representatives in the other system, constructing a process for dealing directly with particularistic interests and communicating particularistic accomplishments. But all citizens will have access to alternative routes for particularistic favors (in some sense all parties can supply favors, not just a single incumbent). Moreover, parties, unlike specific legislators, can not argue simultaneously that they ought to be in power on particularistic grounds and that they are powerless in establishing generic policies.

In parliamentary systems, single-representative districts are more prone to particularism than proportional representation. Parties can solidify power by allowing members of parliament to become favorites with their districts. One way to achieve this is to make them ombudsmen. For example, Cain, Ferejohn and Fiorina show that

British MPs actually spend more time doing constituency service than do members of the U. S. House of Representatives.

The effect of an independent executive is more conjectural. Independence makes legislators more prone to particularism, even under proportional representation, because they are not as accountable for generic policies. But an independent President can not rely as much on favors for specific constituents, owing to the legislature's function in writing laws and making appropriations.

From the voter's perspective, an independent executive offers an escape from the prisoner's delimma created by the legislature. Collectively, citizens can recognize that all are better off if particularism does not drive government policy. Individually, voters are better off voting for candidates and/or parties that supply favors to them. A candidate for chief executive, running separately from the legislature, can promise to implement the cooperative solution: to run against the behavior legislators are prone to pursue. Thus, an independent executive has two effects operating in opposite directions, with an uncertain qualitative resultant: it makes the legislature more particularistic, but the executive less so. The net result depends on the details of the separation of powers between the two branches. For example, in the Fifth Republic, the President controls the agenda of the legislature. This not only makes the legislature very weak, but allows the executive to claim credit for every legislative action. Consequently, both branches should have a particularistic orientation in France.

The conclusion to be drawn from voting theory is that government is more sensitive to particularistic, distributive issues, than to generic effects. Exceptions occur when the performance in a specific area of policy becomes sufficiently poor that, as a generic issue, it becomes salient. This requires one of two eventualities. First, the per capita generic effect becomes high enough to become important in voting decisions. Second, an entrepreneurial party or candidate pays the informational costs of bringing an issue of lesser (but significant) import to the attention of voters. These routes are not totally independent; ceteris paribus, a rational political actor will pick a new issue according to its per capita impact. But they are not the same, either. Elections being relatively low information processes, the attractiveness of a new issue to a political entrepreneur depends on its amenability to presentation to voters in a simple yet dramatic form. Favorites are dollars of gross waste, and horror stories about how some group profits at the public's expense.

Voting and Regulation

The implications for regulatory policy are as follows. Recall that regulatory legislation need not create identifiable winners and losers. The law can be specific, imposing a cost or legalizing a monopoly, or it can be vague, giving regulators and later courts the decision as to who wins and who loses. The political context in which regulatory policy arises should determine this choice.

When regulatory legislation creates identifiable winners at the expense of diffuse losers, such as when it creates a monopoly, the corresponding electoral state should be that the regulatory policy in question has not achieved generic political salience. Thus, legislation creating occupational licensing or agriculture marketing orders should be the result of pressures from a particularistic constituency in the face of ennui in the general electorate.

When regulation creates diffuse winners at the expense of identifiable losers, the electoral foundation should be a salient generic issue, probably placed on the political agenda by a political entrepreneur attempting to enhance his or her power by creating a new public issue with which he or she can be identified. The opposition should be relatively weak, disorganized particularistic groups.

When regulation delegates decisions to a regulatory authority and the courts, shifting the battle to another forum, a case examined by Fiorina and McCubbins, a pivotal number of legislators should face unavoidable controversy. If the issue is not generic, particularistic interests are in conflict. If it is generic, it threatens enough powerful particulartistic interests so that the issue creates an electoral dilemma for politicians. Conceivably, generic issues can be inherently controversial (abortion, monarchy, or the independence of church and state); however, market failures usually lead to consensus on the desirable direction of regulatory policy.

Political Contributions

In many ways, voting and contributing have the same motive, so require little separate analysis. But unlike voting, direct contributions to parties and candidates can register intensities of preferences by the amount of resources given. They are also more likely than voting to relate to particularistic rather than generic issues. One reasons is that contributions have a higher threshhold level of importance that must be crossed to motivate action. Moreover, generic issues pose a more difficult free rider problem for contributors than do particularistic issues. The former require smaller contributions from a larger number of people because small contributions are consistent with the diffuse stake citizens have in generic issues. The latter may pose no free rider problem: a regulated monopoly or a firm with government contracts views contributions as essentially private arrangements with no free-riding beneficiaries.

The role of contributions varies enormously among countries. It is determined by the rules regarding campaign expenditures, the duration of campaigns, and the relative importance of parties in relation to individual candidates. In countries in which campaign expenditures are important and individual contributions are loosely controlled, the force of particularistic issues is enhanced. Making the government the source of campaign resources is not obviously an improvement. If expenditures are important in campaigns, incumbents have an incentive to control public resources to their benefit, and so

to stack the deck against potential political competitors, whether ambitious politicians within a party or new parties. Because political entrepreneurs bring generic issues onto the political agenda, denying them resources can prolong, if not perpetuate, particularistic control of an area of policy, including regulation.

Participation in Policy Processes

A third form of participation is to enter forums for making policy decisions: lobbying political leaders, taking part in an administrative proceeding, or appealing legislative or regulatory outcomes to courts. Like contributions, these forms of participation can reflect intensities of preferences, for they can be pursued with varying cost and effectiveness. Like contributions, they overrepresent particularistic interests, in part because of a higher threshhold of stakes and in part because private actions to alter public policies benefit other, similarly situated people and so face the free-rider problem.

Lobbying is most like contributing; indeed the two are closely associated. People may contribute to candidates to gain access if the need arises, or may promise future resources while lobbying for current support. Moreover, lobbying has few rules and no evidentiary standards.

Regulatory and legal proceedings have a strong element of substance. Effective participation in these forums requires marshalling facts and logic in defense of a favored position.

Consequently, effective participation has a minimum fixed cost, depending upon the technical content of the issue and the number of opposing positions that are represented. The fixed costs correspond to the minimum effort required to marshall relevant facts and an effective presence during a proceeding. Thus, the threshhold of stakes for an issue to motivate participation in these proceedings is higher than for other forms of participation. Moreover, the free rider problem is also more severe. Preparation for participation in a formal proceeding requires generating relevant information for presentation to decision makers. This information is a public good for all who are on the same side of the issue. Hence, participation in these forums faces free-rider problems on both the cost and the benefit side.

All of these phenomena contribute to enhancing particularistic influence in regulatory policy. Regulatory processes, because they stand at the extreme in the number of steps in decision making and in formal evidentiary requirements, present the most formidable fixed cost barriers to effective participation. But one factor working in the opposite direction is that decisions must satisfy higher standards for rationality than in other political or bureaucratic processes -- assuming that regulatory officials actually satisfy them, either for some fundamental reason or because a disgruntled loser may challenge their decisions in court.

The relative importance of this feature of regulation varies according to how the regulatory process is constructed. One dimension of choice is case-by-case versus general rules. If a regulatory

authority adopts only vague general policies, leaving most of the action to specific cases, particularistic forces are enhanced. The objects of regulation -- say, firms engaging in pollution -- have had their side of the free-rider problem ameliorated, for each will face a narrow case in which its welfare is on the line. The generic interest, however, will be diffused over cases, much as pollution results from the combined effects of several independent sources. Case-by-case decisions will have no effect on the incentive of a polluter to participate on the specific issue applying to it, but will substantially reduce the incentive of environmentalists to participate because victory in one case contributes little to an environmentalist's overall objective.

The case-by-case method also makes it easier for regulatory authorities to discriminate among parties. Proceedings that produce general rules require the agency to make specific exceptions if it seeks to favor a special friend. This places a red flag on aspects of the decision that are unequal or exceptional. Because more participants are likely to emerge in a general proceeding, those who seek a special favor are more likely to find opposition. Hence, to the extent outcomes depend on participation and evidence, the agency will be less able to provide particulatistic favors.

Another apsect of agency process is the details of procedural requirements and court review, an issue explored by McCubbins. Agencies vary according to number of stages in the decision process, formal legal requirements, and grounds on which reviews by courts are possible by appeal -- or even required. Procedural complexity increases the costs of participation in ways unrelated to substance. It protracts proceedings (increasing the opportunity cost of participation and delaying its benefits) and increases expenditures on purely representational functions, as contrasted to generating new information for regulators. Procedural complexity, then, filters out some potential participants whose lower stakes do not justify the higher participation costs of a more complex process.

Still another structural dimension is the availability of resources to the agency in relation to the caseload it faces and the technical content of its responsibility. Examples of resources an agency can possess are a technical bureaucracy for independent research and analysis that participates in the agency's proceedings; a communications bureaucracy for disseminating information about agency rules, cases in progress, and technical issues; and a budget for subsidizing participants in its proceedings. An agency that has these resources is obviously more likely to generate evidence opposed to particularistic interests.

All of these structural features can be controlled by political leaders. Thus, they should reflect the political environment that gives rise to regulation. An agency that has cumbersome procedures and few internal resources should reflect a political intent to benefit regulated firms, or at least to minimize the number of competing interests with which the agency must contend. The corresponding political situation should include a strong particularistic interest

and generic interests that are too diffuse to be represented in the detailed design of the regulatory bureaucracy. Generic interests organized by political entrepreneurs are prone to this problem, for obtaining a change in regulation, not designing its implementation, is the simple, dramatic political opportunity.

The old idea of regulatory capture corresponds to this situation. Both particularistic and generic elements are present in establishing the agency, but the agency is oriented toward the particularistic. By contrast, regulation to form a cartel -- say, occupational licensing -- requires neither staff nor cumbersome procedures. Generic interests play no role in its formation, and are unlikely to participate in its processes. Politicians have no reason to impose unnecessary costs on the cartel, and so make the process as cheap as possible, focusing resources on enforcing, rather than writing, cartel rules. In the extreme, the regulatory authority need not be governmental. For example, as dicussed in Berger, some governments, notably Sweden, pursue corporatism, endowing peak associations (labor unions, trade associations) with regulatory powers that escape bureaucratic process altogether. In the United States, the cartel-like Interstate Commerce Commission (ICC), which regulates surface transportation, gave substantial rate-making power to regional trade associations.

A second situation giving rise to cumbersome procedures and few resources is conflict among strong particularistic interests which will participate effectively in regulatory processes. Elaborate procedures distance political leaders from outcomes that are offensive to strong interests, and sparse resources avoid appropriating funds to produce offensive studies. Cumbersome procedures mitigate against participation motivated by diffuse or weak particularistic interests. An example in the United States is the National Labor Relations Board, which regulates collective bargaining. In labor disputes, unions and management are active participants; cumbersome procedures keep out people experiencing secondary effects (consumers, unorganized workers); the structure allows politicians to escape blame from losers.

A process that is rich in resources and procedurally simple invites maximal participation, and hence is minimally particularistic. It should occur when the political environment finds multiple interests that are conflicting, have varying stakes in the issue that make participation sensitive to costs, and are each a political threat. Rich resources are a response to a salient generic political issue or a weak particularistic one. The agency can then provide information that otherwise would not be presented.

The combination of resources and procedural complexity represents a response to still another situation. It limits participation, and gives the agency more independence of action. Thus, it should be a response to conflict between a highly salient generic issue and powerful particularistic forces in a situation in which only the latter is likely to participate, regardless of representation costs.

The effect of agency resources depends in part on what

motivates bureaucrats. The nature of civil service is one in which opportunities for advancement and, especially, financial reward are relatively limited compared to private sector organizations. One can imagine three reasons for pursuing such a career: risk aversion, leading to a strategy to avoid being noticed and hence penalized; power or professionalism, rather than personal advancement, implying independence (perhaps arbitrariness, perhaps pursuit of professional norms); or subsequent opportunities, in politics or the private sector. An agency satisfying the capture or cartel characteristics would be attractive to two types: the risk averse, who seek a quiet, noncontroversial arena, and the power seeker who wants to serve the particularistic purpose of whatever interest controls the agency. The other goals, whether entrepreneurial or professional, require an environment in which one can show independence and demonstrate proficiency at solving problems. The size of the agency also will play some role. An agency that is rich in resources will be more hierarchical to maintain internal control, and hence will offer more opportunities for career advancement, within the limitations of government service. Moreover, it will have the potential to be a mobilizable support group for an internal entrepreneur.

To a political leader, granting substantial resources to a supposedly captured agency is a needless risk. The particularistic interests can supply the information necessary to support its position in court; any attempt to subsidize the cartel by transferring analytic capability to the public budget runs the risk of losing policy control to an entrepreneur or a group with a professional norm of public service, however defined (for economists, surplus maximization; for engineers, technical advancement; for lawyers, preservation of equities and procedural fairness). Because a strong analytical capability invites mischief, rationality requires that it be for the purpose of countervailing the force of those most likely to be represented in the process.

Participation in Interest Groups

Thusfar, the analysis has proceeded under the maintained assumption that political participation of all forms is purely individualistic rather than collective through an organization. This method of argument is intentional -- to demonstrate that particularistic tendencies are a natural part of individualistic political processes even in the absence of organized interest groups. Most of the literature on the political economy of regulation begins with the role of interest groups, creating the impression that somehow interest groups cause the problem of particularism. This conclusion is incorrect; democratic processes create genuine prisoner's delimmas for citizens that political leaders can exploit to their advantage. Nevertheless, interest groups play an important role, especially in regulatory politics, so to ignore them completely would be as misleading as to focus sole attention on them.

Interest groups represent a means for collective acquisition of public goods -- the political outcome, which is simultaneously

acquired by the members, and the information and representation that are required to affect the process. Group cooperation allows members to avoid duplication in acquiring, say, a competent demand analysis for submission into a regulatory proceeding. Pooling of resources also makes groups a greater threat to decision makers, and hence more worthy of their scarce attention.

From the perspective of participants, groups also have costs. First, they must become organized and reach decisions on what position to take and how to share costs. Second, if preferences of members differ, the positions advocated by the collectivity will be at variance with at least some members' most desired position, so that the latter will be less exactly represented by the group than if they each remained fully independent.

In addition, interest groups, like all collectivities, need to overcome free-riding incentives. Some members will seek to avoid joining if they perceive the success of the group to be largely independent of their participation and if the group can not exclude nonmembers from its benefits. Members who join have an incentive to play strategic games in internal decision processes regarding cost-sharing and position-taking so as to maximize their net gains from membership.

These characteristics of interest groups have important implications about the kinds of groups that will be represented in political processes. This issue has been extensively analyzed by Olson and, for groups in regulatory policies, by Noll and Owen. The effect of groups on regulatory outcomes constitutes the heart of the theory of regulation developed by Stigler, Posner and Peltzman. Hence, this discussion will state only the most important conclusions of this work.

1. If two collectivities have the same total stake in an issue, the smaller one will be more likely to be organized into an interest group, all other things being equal, because it will have lower organization costs and less incentive to free ride.

2. If two collectivities are otherwise the same, the one having greater heterogeneity of tastes will be less likely to be effectively organized because it will face higher organization costs and, on average, lower expected policy benefits.

3. If two collectivities are otherwise the same, the one that can exclude nonmembers from some benefits of the organization will be more likely to become organized and, if both are organized, will devote more resources to political participation, because it will have lower organization costs and fewer free riders. A corollary is that groups already organized for another purpose, such as club-like organizations providing private services to members, have an advantage over people whose only common interest is a shared political objective.

4. All other things being equal, a collectivity will be more likely to organize effectively if the stakes of each member of the group are known with certainty than if they are uncertain. Uncertainty enhances the opportunity for strategic behavior in group decision making and, assuming risk aversion, reduces the expected utility from participation. A corollary is that it is easier to organize to defend

the status quo than to change it, assuming the expected stakes of proponents and opponents of change are equal and the groups are otherwise identical.

5. Citizens are more likely to support organizations representing particularistic (income-generating) interests or issues in which public policy is perceived to be most distant from their ideal points (e.g. single issue mass groups) than to groups representing more generic interests because the former groups are likely to be smaller, are likely to involve a higher personal stake, are likely to be more homogeneous, are likely to be organized for another purpose, and are likely to provide a relatively certain personal outcome if successful.

All of the analytical points regarding the identity of represented groups bear close similarity to the reasons why democratic processes have a strong particularistic flavor. This is not surprising, because interest groups are collectivities within the national collectivity, and so have similar participation incentives, and exist as a vehicle for undertaking more cost-effective political participation in that same national process. Less obvious is that their relative importance depends on political institutions, and varies according to the kind of public policy in question.

Consider first the effect of electoral institutions. Nationwide proportional representation, as opposed to single-representative constituencies, enhances the attractiveness of particularistic interests that are rich in electoral resources but poor in financial ones; that is, citizens' groups engaged in single-issue politics and containing a small fraction (but large number) of people that are very disgruntled by a specific policy. Such groups have little chance of gaining influence if they vote in winner-take-all constituencies and make no contributions to major parties or candidates, but have a chance if parties are awarded seats on the basis of total national votes. If the number of splinter groups becomes large, they can become influential because no party appealing to a hetergeneous constituency can achieve power on its own. An example of such a situation is the role of the religious fundamentalists in the Likud coalition in Israel.

The implications for regulation are certainly not obvious to me, but they are unlikely to be nonexistent. Fragmentation of parties probably makes a generic movement relating to regulatory policy (or any other policy) less likely to succeed, but it also increases the number of particularistic interests that have power, some of which can represent more diffuse opponents of groups that might otherwise capture regulation. For example, the Greens in West Germany probably owe their political significance to the system of legislative representation. They act as a radical counterforce in environmental policy to particularistic interests that might use environmental regulation as a device for enhancing their wealth by retarding entry. This could motivate a party in power to undertake a more balanced and efficient environmental policy; but it also reduces the possibility that a centrist political entrepreneur might adopt the generic issue of efficient regulation as a means for attracting political support. The

reason is that without the Greens, the generic issue of regulatory reform would attract some of the Greens' supporters who would see this position as closer than the status quo to their extreme environmentalist interests. Thus, the presence of the Greens could improve the efficiency of environmental policy, but make less likely a more efficient policy, say, regarding prices and entry in telecommunications.

More obvious is the difference in regulation and other kinds of policies in their sensitivity to particularistic interest groups. Weingast, Shepsle and Johnson have provided a useful model for analyzing the relationships between economic efficiency and particularism in the standard areas of public policy: expenditure programs and the structure of the tax system. The principal insight is that political calculations by parties and candidates count some of the costs of a program as benefits -- namely, the income-creating actions that help a loyal constituency at the expense of a constituency one would not have anyway. Particularistic political benefits are essentially linear in dollar payoffs, and are awarded in relation to votes and contributions from particularistic interests. This is the process that members of the Chicago School are modeling: regulatory benefits, like other government goods, are sold in relation to the amount contributed, as explicitly analyzed by Peltzman. This seems to make regulation no different than other forms of policy.

But the straightforward interest-group, supply-demand analysis overlooks two differences between regulation and more prosaic means to supply particularistic benefits. One is that regulation consumes resources of interest groups that could otherwise be spent on parties and candidates. The other is that decisions are constrained by process and evidence, simultaneously limiting the maximum effect of participation and attenuating the connection between politics and decisions.

These aspects of regulation are necessary even if it is purely particularistic. Stigler correctly notes that cartels need regulation to prevent entry. But this can be accomplished quite cheaply, as with occupational licensing or corporatism. It does not explain why regulators and regulated firms are required to devote resources to any activity other than licensing and enforcement.

Compared to other areas of public policy, regulation has a high fixed cost of participation, but beyond the expenditure necessary to present one's case, decreasing marginal returns to further information. Thus, if other interests find it worthwhile to pay the fixed costs against a very well endowed participant, the result will not necessarily be very closely related to the actual or potential amount any group did or could spend in the process.

This leads to the conclusion that regulation can be either more or less particularistic than other programs, depending on the underlying politics and representation. Participation has a minimum efficient scale that depends on how cumbersome regulation is. Hence, regulation can be made highly particularistic -- freezing out all but one interest. Cumbersome agencies with no significant resources can be

used to weaken already weak groups that might have more influence in, say, tax or subsidy policies. Nevertheless, we should expect subsidies to accompany regulatory cartels and capture: if an interest can buy an agency, it can also procure subsidies. In the United States, this seems to be born out. The high point of airlines cartelization through regulation was accompanied by subsidization; the ICC was created in the same era that granted the railroads extensive rights-of-way from the public lands; price and acreage controls in agriculture are accompanied by massive subsidies; and the period when the ICC cartelized trucks also witnessed federal subsidization of state highway systems.

By the same argument, regulatory proccesses that are battlegrounds among contending interests should not be associated with subsidies or other forms of particularism. One does not see. for example, a pattern of subsidies and special tax credits for polluters in parallel with environmental standard setting.

A final unique aspect of regulation is that cause and effect between policy and the formation of interest groups is partly reversed for regulation. Regulation provides a means and incentive for creating interest groups.

After regulation has been in place for a long enough period to affect the structure of an industry, two phenomena emerge. First, expertise at dealing with regulatory, legal and political processes becomes important to a firm's financial performance. People who manage regulated firms will have a strong interest in preserving the regulated status of the industry, even if regulation is not serving the industry's interest, because it enhances their productivity. Prior to regulation, these people will not know who they are; however, once regulation is in place, they will be a well-defined group that can easily organize to lobby for continued regulation.

Second, because regulation changes market equilibria -- high-cost firms are protected, some customers are charged favorable prices, product quality shifts -- firms will have an interest in preventing its disruption. Suppliers may not benefit from the regulatory perturbation, but they will have investments in place that are predicated on serving the market in the way regulation drives it. To protect these investments, they will support the status quo because reforms to improve efficiency would cause a short-term capital loss. Thus, regulatory politics can have the peculiar history that firms fight regulation when it is proposed, but then later fight to prevent deregulation or more efficient regulation. In the United States, truckers fought the adoption of the 55 miles per hour speed limit during the energy crisis of 1973-74, and are now fighting repeal of the same law. In the intervening years, lower speeds (and the implicit capacity reduction they caused) induced entry, which would become excess capacity (and would lower incomes to truckers) if speeds were raised.

Like subsidies, tax benefits and general expenditure programs, regulation provides particularistic benefits, but more than other programs it creates interests that are unidentified when regulatory policy is enacted. One person's inefficiency, whether a regulation-

induced cost or a corporate vice presidency for government affairs, is another person's income.

Also like other programs, the force that threatens a particularistic orientation of regulation is a political entrepreneur who uses inefficiency as an element in raising a generic political issue. Regulation is more vulnerable than other policies to this kind of attack. In addition to the distributional aspects of particularism that it shares with other programs, it creates other costs as well: higher production costs, dead-weight losses, and procedural costs for participants in its processes. Consequently, among particularistic policies, regulation stands near the extreme in the difference between the losses imposed on losers and the benefits conferred to winners. Of the relevant alternatives to regulation, civil litigation is arguably the only one that is a less efficient method for allocating wealth.

This has several consequences. If a subset of losers is relatively easy to organize, the difference in impact provides an extra incentive to do so that may make the difference -- and thereby create the counterforce against particularism. It also makes regulation a good target for a political entrepreneur looking for mismanagement, inefficiency and favoritism to raise as a generic issue. The subset of losers that is organized may help the cause by contributing.

Hence, protectionist regulation creates the conditions for its own reform; at some critical point, the redistributional effects plus the inefficiencies become sufficient to cause a backlash. The location of this critical point depends on the specifics of the program: the size of the losses of the losers, the distribution of losses among them, and the ease with which the problem can be simply and dramatically expressed by a political entrepreneur. Whether regulation can make the list of salient issues also depends on what else is happening in the society. Regulatory reform is an unlikely issue during a war or period of extreme international tension, but it has a good chance if the international scene is relatively placid and the domestic economy is performing poorly.

A common objection against the self-correcting argument described in the preceeding paragraph is that it seems inconsistent with economic equilibrium analysis. Why would rational political actors institute a policy that caused a reaction against itself? Presumably an equilibrium exists, goes the argument, whereby regulatory policy supplies exactly the amount of particularistic favors that is just below the threshhold necessary to induce the reaction against the program.

The reasons that this argument does not hold are as follows. First, elections and legislatures are majority-rule institutions, and these do not necessarily have an equilibrium. To be sure, as Shepsle's analysis shows, legislators have means available to protect against the instability of electoral institutions, whether the internal structure of the legislature in countries in which representatives are autonomous or the party system that predominates in parliamentary democracies. But these mechanisms delay more than permanently suppress disequilibrium. As Riker has cogently argued, the job of the political

entrepreneur in the face of electoral instability is to identify new issues that will upset the status quo.

Second, random, exogenous events determine which issues achieve general political salience. Only in an expected value sense could political leaders calculate the regulatory policy that was optimally particularistic. Unless political leaders are extremely risk averse (and hence create regulatory policies that are not very particularistic), at some point external events would conspire to make particularistic regulation a generic political issue.

Third, a policy reversal in a particularistic program does not necessarily disadvantage the political leaders who created it. Recall that elections are low-information processes. Candidates do not make particularistic favors part of the public rhetoric of a campaign; generic issues occupy speech writers. Hence a politician who created a particularistic program can later run against it when its effects become a generic issue. This is especially likely to be the case in nations having independent legislative and executive branches, for then generic issues are likely to be fought out in presidential elections.

For these reasons, regulatory policy can have variable characteristics over time. It is unlikely permanently to facilitate a cartel; however, it is unlikely to be insensitive to organized, supply-side interests. It is unlikely to be consistently an important national political issue or an invisible political backwater.

III. Summary and Conclusions

Regulation was the source of a great deal of cynicism by American academics during the 1960s and 1970s. The standard view was that regulatory policy was an evil conspiracy among politicians and select industries to construct an enforceable cartel. But at the peak of this cynicism, two developments took place that were inconsistent with it. One was the rise of environmental, health and safety regulation, which target industries almost universally opposed. The other was extensive reform and rationalization of regulation: deregulation in workably competitive industries that were subject to economic regulation and mandatory economic impact analysis for cases in which market failure is more plausible.

The political foundations of these changes are built of the same bricks that formed the foundations for the protectionism that caused the wave of academic cynicism. The same polity that gave the U.S. airline deregulation in the 1970s produced airline regulation in the 1930s, and a new economic regulatory agency -- for commodity futures trading -- simultaneously with the beginning of airline deregulation.

The key to understanding regulation is only partly in the heavy participation of organized, supply-side interests in the regulatory policy process. This can produce cartelization if others are asleep. But the rest of the story is that regulation is an extraordinarily cumbersome way to provide particularistic favors. Indeed, because its fact-finding and decision-making processes exhibit decreasing returns and make decisions depend on evidence, they give other interests as good

a chance as one can imagine in a political process. If the agency is given policy-making discretion, a simple process, and resources adequate to sift through the self-serving material submitted by represented interests, regulation is probably as removed from straightforward pluralist, interest-group politics as is possible.

Moreover, regulation has the potential for attracting general public attention when it goes stale. People genuinely believe the rhetoric that regulation is supposed to protect society from market failures. This means that they expect regulation to confer net social benefits: winners ought to gain more than is lost by losers. Regulation is also a sloppy form of cartel; if it becomes one, the inefficiencies tend to dissipate the gains of cartel members. This means that the losses of the losers are large compared to the gains of the victors, a situation that attracts political entrepreneurs.

In the economic regulatory sphere, most nations do not engage in extensive regulation of the narrow, technical form that is practiced in the United States. Among the alternatives is a nationalized entity, which suggests parallels to the American postal service: should the public enterprise be a ministerial office, directly run by the political process, or a quasi-independent authority that is regulated by a government bureau? Another possibility is corporatism, which lets industry regulate itself with loose ties to government.

The thrust of the argument in this paper is to favor approaches involving an intermediating, resource-rich agency. The reason is that the regulatory process provides some opportunity for checking the particularistic pressures that is missing in public expenditure programs or administrative methods lacking procedural safeguards. The argument of this paper is that, indeed, such a change will take place when the performance of ministerial public enterprise or corporatism gets bad enough, for some political entrepreneur will eventually sense the opportunities in raising the issue. In parliamentary systems with single-representative constituencies, like Britain, however, one can wait a long time before observing this event.

With respect to social regulation, the conclusions from political economic analysis are as follows. Economic incentives -- taxes and subsidies -- are less attractive than economic theory implies. Both are more susceptible than regulation to particularism, whether implemented through case-by-case bureaucratic decisions or legislation. To be efficient, they must be applied differentially among industries and even firms, which opens the door to political determination of differences. A similar argument applies to greater reliance on civil litigation. It has high participation costs and requires case-by-case decisions.

Among the alternatives, the most promising is artificial markets for property rights in exposing society to risks, as examined in Noll. This requires a process to define acceptable risk and to establish and enforce the property rights; however, markets allocate rights among producers of risks. The regulatory component is general rule-making; the decisions about how each firm will respond to rules are decentralized through a market. The first invites maximal

participation; the latter avoids the step in which particularistic forces are most likely to be controlling. Normatively, this approach should be superior to current methods of regulation; positively, whether they will be adopted depends on how badly social regulation performs and how long it takes for the political environment to ripen so that reform becomes salient.

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